COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter:

A FORMAL REVIEW OF WESTERN KENTUCKY GAS COMPANY'S DECISION TO TERMINIATE A NATURAL GAS SALES, TRANSPORTATION AND STORAGE AGREEMENT WITH NORAM ENERGY SERVICES, INC. AND ENTER INTO A NATURAL GAS SALES, TRANSPORTATION AND STORAGE AGREEMENT WITH WOODWARD MARKETING, L.L.C.	)	CASE NO. 99-447

O R D E R

On November 5, 1999, the Commission entered its Order in this proceeding initiating a formal review of Western Kentucky Gas Company's ("Western's") termination of its contract with NorAm Energy Services, Inc. ("NorAm") and its subsequent execution of a contract with its affiliate, Woodward Marketing, L.L.C. ("Woodward"). The Attorney General's Office ("AG") was granted intervention in this proceeding. On November 23, 1999, Western filed a motion to dismiss this review, which will be addressed herein. The AG filed a reply to Western's motion, stating that the review was properly initiated.

Data requests were issued on November 23, 1999 and January 14, 2000. Western provided responses on December 27, 1999 and January 31, 2000. The AG filed no testimony in this proceeding.

The Commission's Order of November 5, 1999 outlined its concerns to be addressed in this docket. Specifically, the Commission believed it to be imperative to determine whether a record of evidence existed supporting the reasonableness of the actions taken by Western, a division of Atmos Energy Corporation ("Atmos") in addressing necessary changes in its gas supply situation. Western has made several references to the fact that its Experimental Performance-Based Ratemaking mechanism ("PBR") is supposed to eliminate the need for after-the-fact prudence reviews. While under normal circumstances, a certain presumption of prudence is inherent in established benchmark standards of performance, Western's experience with NorAm and Woodward does not constitute normal circumstances. A contract involving the management of Western's sales, transportation, and storage was voluntarily terminated with one supplier and subsequently awarded to an affiliate who had originally offered a less favorable bid than the first supplier. This fact in itself is sufficient to indicate a need for detailed documentation of the origin of the problem with the first supplier, NorAm, the options available to Western, the decision-making process, the ultimate decision to award the contract to the affiliate, Woodward, and the expected impact on ratepayers.

Having considered the evidence of record in this case and being otherwise sufficiently advised, the Commission finds that:

1. Western's motion to dismiss should be denied.

2. Western acted reasonably and in the best interest of its customers and shareholders in regard to the termination of the NorAm contract. The possibility of NorAm, now Reliant Energy Services ("Reliant"), taking on an unacceptable level of risk in order to minimize its losses was a sufficient threat to supply reliability to explain Western's actions in the contract termination. Using industry articles from the time

period in question, Western has documented the market conditions that caused NorAm to experience financial distress as a result of the contractual arrangement with Western.

3. Western acted reasonably and in the best interest of its customers and shareholders in accepting Reliant's buy-out offer. Western has been able to show that customers and shareholders will share savings that are practically identical to those that would have been realized under the original NorAm agreement. These savings are a result of the combination of the Reliant buy-out and the gas cost savings offered by Woodward.

4. Western has provided sufficient information to support its belief that putting the contract out for bid again would most likely have resulted in gas costs significantly higher than they had been under the NorAm contract. Western expected that bidders would consider NorAm's failure as well as current market conditions in formulating their bids, and that as a result the bids would be less favorable. Western provided industry articles that described market conditions as they existed and changed from May 1998 through March of 1999. Storage inventory levels were high, the winter was considerably warmer than normal, gas prices were low, and there was low price volatility. The Commission agrees it was reasonable to assume that the same conditions that made the contract unprofitable for NorAm would make the opportunity to manage Western's assets less attractive for potential bidders as well. Woodward was willing to honor its original bid, which had been second best after NorAm's.

5. Western did not violate its code of conduct by awarding the contract to Woodward. Woodward had been the second best bidder as a result of the original competitive bid process, and its bid had been significantly better than the remaining

conforming bids. There was no reason to believe that Western would receive more favorable bids in a second round from bidders who had submitted higher cost bids under earlier, more favorable market conditions.

IT IS THEREFORE ORDERED that:

1. Western's motion to dismiss is denied.

2. The Commission is satisfied that Western acted reasonably and in the public interest, and this proceeding is closed.

Done at Frankfort, Kentucky, this 14th day of April, 2000.

By the Commission

ATTEST:

Executive Director